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Taxation

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X. Taxation

A. Gifts in Trust to Minors and the Annual Exclusion—Crummey v. Commissioner, 397 F.2d 82 (9th Cir. 1968).

"Perhaps the most persistent problem in applying the gift tax law relates to the $3,000 annual exclusion per donee."[1] In *Crummey v. Commissioner*[2] the Ninth Circuit joins other courts in struggling with one aspect of the problem—the annual exclusion as applied to gifts in trust to minors.[3]

In *Crummey* the taxpayers created an irrevocable, inter vivos accumulation trust for the benefit of their four children. The pertinent provision of the trust was the demand provision which permitted the children to demand and receive a maximum of $4,000 in any year in which a gift was made to the trust.[4] This provision was

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[1] M. CHIRELSTEIN, L. DAY & E. OWENS, TAXATION IN THE UNITED STATES 256 (1963).

[2] 397 F.2d 82 (9th Cir. 1968), *aff'g* 25 CCH Tax Ct. Mem. 772 (1966).

[3] Congress examined the subject of gifts in trust to minors in the 1950's. This examination resulted in the addition of section 2503(c) to the Internal Revenue Code. This section provides a method by which the taxpayer may make such a gift and still receive the annual exclusion. If the income and corpus may be used for the minor's benefit prior to his majority, if the trust will terminate when the minor attains the age of 21, and if the corpus must pass to him or his estate or as he shall appoint under a general power of appointment, then the annual exclusion is allowed the donor. In adding this section Congress noted that "[g]ifts to minors are often hindered by the fact that it is not clear how such a gift can be made in trust . . . other than as a future interest." S. REP. No. 1622, 83d Cong., 2d Sess. 127 (1954).

The Internal Revenue Service has stated that this provision is not to be considered as the exclusive method for giving gifts in trust to minors and the residual complexities which arose under the old law remain. Treas. Reg. § 25-2503-4(c) (1958). Therefore, a donor who does not choose to comply with the new provisions may still attempt to give a gift of a present interest under the pre-1954 law and thereby obtain an annual exclusion as provided by the Code. Many donors, however, will prefer to avail themselves of the new section, because, if it is strictly complied with, it is immaterial whether the gift is of a present or a future interest. *See generally* C. LOWNDES & R. KRAMER, FEDERAL ESTATE AND GIFT TAXES § 33.10-.11 (2d ed. 1962); 5 J. MERTENS, LAW OF FEDERAL GIFT AND ESTATE TAXATION, §§ 38.01-.38 (1959); Caplin, *How to Treat Gifts to Minors*, N.Y.U. 13TH INST. ON FED. TAX. 193 (1955); Ehrlich, *Tax Aspects of Gifts to Minors*, 46 MASS. L.Q. 310 (1961); Louthan, *Trusts for Minors*, TRUST BULL., Oct. 1955, at 24.

[4] The instrument provided that the trustee could receive additions to

inserted in order to create a gift of a present interest and to secure, therefore, the benefit of the annual exclusion to the donors.[5] Gifts were made to the trust in two successive years; in the first year one of the four children was an adult, and in the second year two of the four were adults. Under the gift-splitting provisions of the Code the taxpayers each claimed an annual exclusion of $3,000 for each donee.[6] The Commissioner determined a deficiency in the gift tax payable for each year in question on the ground that only those gifts made to adult beneficiaries were of present interests.[7]

The Tax Court[8] held that the gifts to the two youngest donees were of future interests, relying on *Stifel v. Commissioner*[9] wherein

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the trust corpus in any year and that "[w]ith respect to such additions, each child of the Trustors may demand at any time (up to and including December 31 of the year in which a transfer to his or her Trust has been made) the sum of Four Thousand Dollars ($4,000.00) or the amount of the transfer from each donor, whichever is less, payable in cash immediately upon receipt by the Trustee of the demand in writing and in any event, not later than December 31 in the year in which such transfer was made. Such payment shall be made from the gift of that donor for that year. If a child is a minor at the time of such gift of that donor for that year, or fails in legal capacity for any reason, the child's guardian may make such demand on behalf of the child. The property received pursuant to the demand shall be held by the guardian for benefit and use of the child." 397 F.2d at 83 (emphasis of court deleted). This particular demand provision is novel. The demand provision in question has not been so limited in prior cases. In those cases the demand could be made by the beneficiary at any time, and it did not expire as it did in the instant case. *See, e.g.*, the demand clause in John W. Kieckhefer, 15 T.C. 111 (1950), note 30 *infra*.

[5] "In the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year . . . the first $3,000 of such gifts to such person shall not . . . be included in the total amount of gifts made during such year" for purposes of the gift tax. INT. REV. CODE OF 1954, § 2503(b).

[6] INT. REV. CODE OF 1954, § 2513(a) provides that a gift by one spouse may be treated as being made one half by each for gift tax purposes. In Helvering v. Hutchings, 322 U.S. 393, 396-97 (1941), it was held that the beneficiary of a trust and not the trustee is the donee under the statutory phrase "any person." Int. Rev. Code of 1932, § 504(b), 47 Stat. 247 (now INT. REV. CODE OF 1954, § 2503(b)). As a result, the donor can receive a $3,000 exclusion ($5,000 at the time of *Helvering v. Hutchings*) for each donee and take advantage of the provision in each year in which a gift to the trust is made.

[7] Definitions of present and future interests are found in the regulations as follows:

a) "' Future interests' is a legal term . . . [denoting interests] which are limited to commence in use, possession or enjoyment at some future date or time." Treas. Reg. § 25.2503-3(a) (1958). *See generally* Note, *Taxation—Gift Taxes—Gift in Trust for Minor is Present Interest if Beneficiary or Legal Guardian May Demand Immediate Termination*, 65 HARV. L. REV. 703 (1952).

[8] D. Clifford Crummey, 25 CCH Tax. Ct. Mem. 772 (1966).

[9] 197 F.2d 107 (2d Cir. 1952), *rev'g* 17 T.C. 647 (1951). See text ac-

it was held that in the absence of an appointment of a guardian there was no one who could make an effective demand since the minors were under legal disabilities. It was conceded that the gifts to the adults were of a present interest.[10] An exclusion was allowed for the minor who was 20 years old at the time of the first gift on the theory that under state law she could make an effective demand.[11]

The court of appeals reversed the Tax Court in an exhaustive opinion.[12] As the taxpayers in *Crummey* did not comply with the new Code provisions,[13] it was imperative that the gifts be deemed to be of a present interest to qualify for the annual exclusion. The court of appeals held the gifts to all donees to be of present interests, including those made to minor beneficiaries.[14] The basis of this conclusion was the application of an objective test for the determination of whether the gifts were of present or future interests. The court stated that the test should seek to determine whether the minor beneficiary received present legal and technical rights under the trust instrument, with the inquiry directed to the trust document and the laws of the jurisdiction as to minors. Considerations of a subjective nature, such as the probability of a demand being made, should not be entertained.[15]

The court's position in *Crummey* was an attempt to resolve a conflict in earlier cases which sought to determine the status of gifts for tax exclusion purposes.[16] Congress enacted the future interest exception because it "apprehended [the] difficulty, in many instances, of determining the number of eventual donees and the values of their respective gifts."[17] The courts did not restrict the application of the rule to such difficult situations, however, but denied the exclusion with regard to all gifts which were classified

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companying notes 44-48 *infra*.

[10] D. Clifford Crummey, 25 CCH Tax. Ct. Mem. 772, 773 (1966).

[11] *Id.* at 774-75. The court thought that in California a minor over the age of 18 was accorded sufficient additional legal rights to make an effective demand. The court relied on Civil Code section 33 which provides that "[a] minor cannot . . . under the age of eighteen, make a contract relating to real property, or any interest therein . . . ." CAL. CIV. CODE § 33.

[12] Crummey v. Commissioner, 397 F.2d 82 (9th Cir. 1968).

[13] See note 3 *supra*.

[14] Crummey v. Commissioner, 397 F.2d 82, 88 (9th Cir. 1968).

[15] *Id.*

[16] Some writers have felt that the problem does not deserve as much attention as has been given it. "Excessive preoccupation of taxpayers and their counsel with the annual $3,000 gift tax exclusion for gifts to minors makes *John W. Kieskhefer, Kieckhefer v. Commissioner*, and *Arthur C. Stifel, Jr.* interesting quite out of proportion to their true significance." Rogers, *Stifel Stifles Kieckhefer*, 7 TAX. L. REV. 500 (1952).

[17] H.R. REP. No. 708, 72d Cong., 1st Sess. 29 (1932).

as future interests.[18] Therefore, taxpayers were required to tailor their gifts to the Code and the existing judicial interpretations thereof to obtain an annual exclusion. As the statutes and decisions were rather uncertain, this was a difficult proposition.[19] The most difficult problems have been encountered in connection with gifts in trust to minors.[20]

It is now agreed that absolute, unrestricted ownership and possession, once conveyed, creates a present interest in the donee. When less than this absolute ownership has been transmitted, the search has been for an equivalent of ownership.[21] If such equivalent is not found, the gift is deemed to be of a future interest and the annual exclusion is denied.[22]

An examination of the earlier judicial applications of the future interest rule to trusts containing demand provisions illuminates the importance of the *Crummey* decision in establishing an overall test for ascertaining the equivalence of ownership necessary to establish a present interest for tax exclusion purposes.

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[18] *See, e.g.*, Fondren v. Commissioner, 325 U.S. 18 (1945).

[19] It was not disputed that a gift in hand to an adult was a gift of a present interest. There was some initial conflict as to whether a gift in trust to an adult was a gift of a present interest. Between the years 1939 and 1943 the statute disallowed any exclusion for a gift in trust. Revenue Act of 1934, § 505(a), 52 Stat. 565. The annual exclusion was restored for such gifts in 1943. Revenue Act of 1942, § 454, 56 Stat. 953 (now INT. REV. CODE OF 1954, § 2503(b)). The treasury now concedes that a gift in trust for the benefit of an adult donee may be a gift of a present interest. Treas. Reg. § 25.2503-2 (1958).

The status of gifts to minors is yet to be completely resolved. Initially there were some authorities who disputed that even an outright gift to a minor would constitute a present interest. Fleming, *A Different View of Outright Gifts to Minors*, 7 TAX. L. REV. 89 (1951); Fleming, *Gifts for the Benefit of Minors*, 49 MICH. L. REV. 529 (1951). Other writers regarded the question as unsettled. Anderson, *Gifts to Children and Incompetents*, 26 TAXES 911 (1948); Diamond, *Tops and Dolls—or Gifts to Minors*, 30 TAXES 987 (1952). While it has not been litigated, the question appears to have been resolved in favor of the minor. It is now agreed that a gift directly to a minor's legal guardian can be of a present interest. Rev. Rul. 54-400, 1954—2 CUM. BULL. 319.

[20] "Almost in vain, the donors sought for a magic formula for making a gift in trust, particularly for the benefit of minors, which would pass the 'future interest' hurdle and at the same time avoid the donor's natural reluctance to vest full control of the property and the income in immature and inexperienced donees." Lentz, *Drafting a 2503(c) Trust for a Minor*, 38 DICTA 11, 12 (1961).

[21] "[A] present power of disposition for one's own benefit is the equivalent of ownership. . . ." Ryerson v. United States, 312 U.S. 405, 408 (1941).

[22] See note 5 *supra*.

Historical Development

In *Fondren v. Commissioner*[23] the Supreme Court drew a definition of the term "present interest" for purposes of the gift tax. The trust in that case did not include a demand provision. The trustee was given a discretionary power of invasion to be exercised whenever the circumstances of the beneficiary warranted. The Court noted that the parents of the beneficiary were of ample means and that it was improbable that the trustee would be required to distribute to the beneficiary.

The Court held the gift to be one of a future interest saying, "[t]he question is of time, not when title vests, but when enjoyment begins."[24] It was indicated that a gift is not of a present interest if *any* circumstances operate to restrict the donee's ability presently to enjoy the gift.[25] In defining a present interest the Court said, "he must have the *right* presently to use, possess or enjoy the property."[26] Further, "[t]he important thing is the certainty of postponement, not certainty of the length of its duration."[27] The Court said that the question is essentially one of when enjoyment is to begin.

It is clear that the Supreme Court in *Fondren* was attempting to delineate one concept. In any given situation, if there is a certainty of postponed enjoyment, there must of necessity be restrictions on the donee's present ability to enjoy the property, and, consequently, there would be no present right of enjoyment. Barriers would then exist between the donee's right of enjoyment and the gift. It is submitted, however, that the courts which had occasion to apply the *Fondren* concept did not understand that there was a latent ambiguity in the Court's definition and test. It was not indicated by the language of the Court as applied to the facts of the case whether the Court was proposing an objective or a subjective test or some combination of the two. The language of the Court is subject to two

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[23] 324 U.S. 18 (1945).

[24] *Id.* at 20.

[25] "Whatever puts the barrier of a substantial period between the will of the beneficiary or donee now to enjoy what has been given him and that enjoyment makes the gift one of a future interest within the meaning of the regulation." *Id.* at 20-21 (dictum).

[26] *Id.* (emphasis added). It has not been contended by the treasury that a donee must take actual physical possession and then make actual use of the donated property in order for the gift to be of a present interest. It is sufficient that he have the unrestricted right to use the property whenever he shall so determine.

[27] *Id.* at 26. On the facts of the case the court held the gifts to be of a future interest on the theory that the power of invasion being discretionary with the trustee rendered the gift contingent on the exercise of that discretion.

possible interpretations: (1) in order to find a gift of a present interest it is necessary that there be an absence of *legal* restrictions on the donee's ability to enjoy the property; (2) in order to find a gift of a present interest there must be an absence of legal restrictions coupled with restrictions in *fact* which operate to cause postponed enjoyment.[28]

Apparently, no court has noticed that the definition and test were ambiguous. Each court has seen at least one aspect of the concept and has proceeded to derive its own test. Due respect was paid to the *Fondren* language, and apparently the courts were convinced that they were conforming with the concept identified by the Supreme Court.

The Kieckhefer Decisions

The first court to apply the *Fondren* test to a trust containing a demand provision was the Tax Court in *John W. Kieckhefer*.[29] The donor had established an accumulation trust for his newborn grandson. The trustee was granted a discretionary power of invasion as in *Fondren*, but a demand provision was also included in an attempt to make the gift one of a present interest.[30] The court held the gift to be one of a future interest, relying on the postponement of enjoyment language in *Fondren*.[31] The holding was that an infant could not make an effective damand due to his natural and legal disabilities and that, in the absence of the appointment of a legal guardian, there was no one who could exercise the demand power.[32]

The Seventh Circuit reversed the Tax Court, holding that the demand provision did indeed create a present interest in the donee.[33] Also relying on *Fondren*, Chief Judge Major said, "[i]t is not, however, the use, possession or enjoyment . . . [of the property], but

[28] For example, it may be necessary to consider the age of the donee to determine whether he has the physical capacity to make an effective demand.

[29] 15 T.C. 111 (1950), *aff'd*, 189 F.2d 118 (7th Cir. 1951).

[30] "The beneficiary shall be entitled to all or any part of the trust estate or to terminate the trust estate in whole or in part at any time whenever said [beneficiary] or the legally appointed guardian for his estate shall make due demand therefore . . . ." *Id.* at 113.

[31] The court said, "[w]e have no doubt that the intent of the [donor] . . . was to provide some estate for his grandson at the age of 21, subject, however, to a contingent but unanticipated need in the interval." *Id.* at 115.

[32] In this case the court noted both the natural and legal disabilities of the minor. "Certainly no one could convincingly contend that an infant of six months was capable of making effective demand for any part of the estate, whether in writing or otherwise, and the situation would, we think, be the same even if we should assume a minor two, four, six, eight, ten, or more years older than the beneficiary in this case." *Id.* at 115-16.

[33] Kieckhefer v. Commissioner, 189 F.2d 118 (7th Cir. 1951).

it is the *right* conferred upon the beneficiary to such use, possession or enjoyment"[34] which distinguishes a present interest from a future one. The Tax Court had noted the disability of the minor and its considered effect on his right to make an effective demand. The court of appeals noted that a provision in a similar accumulation trust for the benefit of an adult would create a gift of a present interest. The appellate court did not think that Congress intended discrimination between minors and adults with regard to the application of the gift tax, and, accordingly, held the gift to be one of a present interest.[35]

Fondren was distinguished by the appellate court as involving "trust agreements which by their terms contained the restrictions and conditions which led the Court to decide that the gifts were of a future interest."[36] The court of appeals further reasoned that the decision in *Fondren* was based on the contingency of need ever arising and that this contingency was imposed by the trust instrument. In *Kieckhefer* the restriction was not imposed by the trust instrument, but by state law involving the consequent disabilities of minority.[37] Ostensibly, the court was concerned that a decision sustaining the Commissioner's position would have a deleterious effect on the frequency of gifts being made in trust to minors.[38] The court must have thought that it was necessary to hold the gift to be one of a present interest in order to encourage such gifts. The holding was that where restrictions on the gift were not imposed by the donor, but were imposed by state law, such restrictions should be disregarded; and if the gift would otherwise be one of a present interest, that determination should not be changed by the mere fact that the donee was a minor.[39]

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[34] *Id.* at 121 (emphasis added).

[35] The court is supported in this argument by the Supreme Court in *Fondren*. "The argument is appealing, in so far as it seeks to avoid imputing to Congress the intention to 'penalize gifts to minors merely because the legal disability of their years precludes them for a time from receiving their income in hand currently.'" Fondren v. Commissioner, 324 U.S. 18, 29 (1945) (dictum).

[36] Kieckhefer v. Commissioner, 189 F.2d 118, 120 (7th Cir. 1951).

[37] The court remarked that the Commissioner's argument as applied to this case meant that the beneficiary must have the actual possession and use of the gift in order for it to be a present interest. The court observed that Congress did not intend that "the beneficiary [occupy] the same position relative to the gift that a boy sustains to his top or a gift to her doll." *Id.* at 121.

[38] "[N]o illustration is given as to how a gift of a present interest could be made to a minor . . . ." *Id.*

[39] It is important to distinguish "between restrictions and contingencies imposed by the donor (in this case the trust instrument), and such restrictions and contingencies as are due to the disabilities always incident to and

The *Kieckhefer* court hinted at a broad test. The source of the restrictions should be ascertained if such restrictions upon present enjoyment are found by the court. If the restrictions are not donor-imposed, they should be disregarded.

It is important to observe the difference in approach taken by the Tax Court and the Seventh Circuit. The Tax Court concerned itself with the intent of the donor, and with the natural and legal capacity of the donee to make an effective demand. It examined all the surrounding circumstances and the trust document and concluded that the demand provision, which purported to create a present interest, was not likely to be exercised. The court found that there was to be a certainty of postponed enjoyment at least in the nonlegal sense of factually postponed economic benefit. The test adopted by the Tax Court was a subjective one.

In contrast, the Seventh Circuit sought an objective test. It did not attempt to ascertain either the intent of the donor or the probability of a demand being made. It confined its search to the trust instrument and did not consider extrinsic facts and circumstances.[40] Ostensibly, the test sought was whether any legal rights to present enjoyment were conveyed. The court mentioned that if this same gift were made to an adult, present legal rights would have unquestionably been conveyed.[41] The court assumed, without discussion, that the legal disability of the minor beneficiary prevented him from making an effective legal demand. The court was unconcerned with physical capacity, and indeed no mention was made of the age of the donee. Still, the court was forced to the conclusion that no present legal rights were conveyed by the donor, absent the appointment of a guardian. However, as this conclusion would mean discrimination as to minors and would discourage gifts to minors,[42] the

associated with minors. . . ." *Id.* at 122; *accord*, United States v. Baker, 236 F.2d 317 (4th Cir. 1956); Cannon v. Robertson, 98 F.Supp. 331 (W.D.N.C. 1951); Beatrice B. Briggs, 34 T.C. 1132 (1960); *see* Gilmore v. Commissioner, 213 F.2d 520 (6th Cir. 1954); Commissioner v. Sharp, 153 F.2d 163 (9th Cir. 1946); Strekalovsky v. Delaney, 78 F. Supp. 556 (D. Mass. 1948). *See also* Forbes, *Gifts to Minors*, 19 MONT. L. REV. 106, 108 (1958).

[40] See note 39 *supra.*

[41] Kieckhefer v. Commissioner, 189 F.2d 118, 121 (7th Cir. 1951).

[42] It is submitted that this was the primary consideration of the appellate court. At that date few, if any, courts had held that a gift could be made in trust which would qualify for the annual exclusion. The court was clearly concerned with the detrimental effect that this might have on donors who desired to give gifts to minors, and still provide for proper management and control of the gift. Few donors would desire to give substantial gifts directly to a minor since he cannot be expected to possess the maturity and judgment that is required for proper management and conservation of the donated property. See note 38 *supra.*

court was required to disregard the legal disabilities imposed by state law.[43]

The *Kieckhefer* decision was something of a *cause celebre* and was much noted.[44] While the decision generated considerable excitement, it was not subsequently followed by the Tax Court, and, undoubtedly, there were more than a few disappointed taxpayers.

The Stifel Decisions

In *Arthur C. Stifel, Jr.*[45] the courts were presented with a problem very similar to that faced in *Kieckhefer*. While there were certain factual differences,[46] both cases turned on the effect to be given to the demand provision. The Tax Court reiterated its position in *John W. Kieckhefer* and again considered all the surrounding circumstances. It found that the donor intended that no demand was to be made except in unusual circumstances. Absent the appointment of a guardian there was no one who could make an effective demand, and, therefore, the gift was held to be a future interest.

The Second Circuit affirmed the decision of the Tax Court, saying:

> It is urged that neither the Tax Court nor we may properly consider these items, since they involve restrictions not contained in the trust

[43] Kieckhefer v. Commissioner, 189 F.2d 118, 122 (7th Cir. 1951). The Ninth Circuit, in *Crummey*, noticed this, saying, "The court [in Kieckhefer] equated a present interest with a present right to possess, use or enjoy. The facts of the case and the court's reasoning, however, indicate that it was really equating a present interest with a present right to possess, use or enjoy except for the fact that the beneficiary was a minor. . . . [A third] possibility is that the court should determine whether the donee is legally and technically capable of immediately enjoying the property. . . . [T]he question would be whether the donee could possibly gain immediate enjoyment and the emphasis would be on the trust instrument and the laws of the jurisdiction as to minors." Crummey v. Commissioner, 397 F.2d 82, 86 (9th Cir. 1968). It is submitted that the "third possibility," *i.e.*, whether the minor was legally and technically capable of immediately enjoying the property, was the test sought by the appellate court in *Kieckhefer*. See text accompanying notes 40-43 *supra*. However, as the court in *Crummey* read *Kieckhefer*, it thought that the test enunciated by that court was that "postponed enjoyment is not equivalent to a 'future interest' if the postponement is *solely* caused by the minority of the beneficiary." Crummey v. Commissioner, *supra* at 88 (emphasis added). Therefore, the Ninth Circuit distinguished *Kieckhefer* on the ground that failure to make a timely demand would also cause postponed enjoyment in the *Crummey* trust. Therefore, the minority of the donee might not be the *sole* cause for postponed enjoyment.

[44] *See, e.g.*, Rogers, *Stifel Stifles Kieckhefer*, 7 TAX. L. REV. 500 (1952); 65 HARV. L. REV. 703 (1952); 36 MINN. L. REV. 295 (1952).

[45] 17 T.C. 647 (1951).

[46] One of the major differences was that in *Kieckhefer* the income was to be accumulated subject to a demand, while in *Stifel* the income was to be paid out as earned either to the beneficiary, guardian, if any, or the donee's parent.

> instrument. . . . But in *Fondren* . . . the Supreme Court, in determining the nature of the rights conferred by the trust instruments, took account of "surrounding circumstances"; the Court, in reaching its determinations, did not irrevocably lock itself inside the "four corners" of the writings but held that the key might lie outside. Were this not the rule, a donor could make gifts which on paper were 100% present but in practice were 100% future.[47]

The court depreciated the stated fear that no gifts could be made to minors that would qualify for the annual exclusion.[48] The court also agreed with the Tax Court that without the appointment of a legal guardian no one existed who could make an effective demand.[49]

Thus the lines were drawn. The *Kieckhefer* court supported a purely objective approach, while *Stifel* spoke for a subjective test.[50] Both courts of appeals claimed to rely on the *Fondren* decision, yet each reached a different conclusion when faced with essentially the same factual situation. As previously indicated, the conflict was caused by the latent ambiguity in the *Fondren* test.[51] However, until the Ninth Circuit decided *Crummey*, no court had clearly identified the conflict and sought to make a rational choice between the opposing points of view.

The Crummey Decision

In *Crummey*, Judge Byrne, writing for the Ninth Circuit, rejected the test announced by *Stifel*. He regarded a subjective test as untenable because "the solution suggested by that case is inconsistent and unfair. It becomes arbitrary for the I.R.S. to step in and decide who is likely to make an effective demand . . ."[52] and who is not.

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[47] Stifel v. Commissioner, 197 F.2d 107, 110 (2d Cir. 1952).

[48] "We believe that this view under-estimates the traditional judicial knack of line-drawing." *Id.*

[49] It is not clear whether the donee's interest would have been considered a present interest even if a guardian had been appointed. The intimation in the court's opinion to this effect is qualified by a footnote: "It would then seem to be proper to consider the actual facts as to the father's influence on the guardian appointed." *Id.* at 110 n.5; *see* Note, *Gifts to Minors as Present Interests for Purposes of the Annual Exclusion of the Federal Gift Tax*, 53 COLUM. L. REV. 530 (1953).

[50] It is unclear whether the court adopted a purely subjective test or whether it assumed that both substantive and legal barriers must not be present in order to find a gift of a present interest. It appears that this court thought that the disabilities of minority, both natural and legal, precluded the beneficiary from making a demand. No indication was given as to what the decision would have been had there been no legal barriers, but only a barrier in the nonlegal sense of factually postponed economic benefit. It is submitted that the decision would have been the same, since the Second Circuit considered all surrounding circumstances.

[51] See text accompanying notes 27-28 *supra*.

[52] Crummey v. Commissioner, 397 F.2d 82, 88 (9th Cir. 1968).

The Tax Court in *Stifel* considered the intent of the donor and the financial circumstances of those responsible for the support of the minor beneficiary in order to discover the likelihood that a demand would be made.[53] The Ninth Circuit rejected such considerations.[54] The criticism of Judge Byrne is partially supported by the Supreme Court: "So far as the argument turns on the motive of the donors, it may be answered that the statute and the regulations make no such test."[55]

Judge Byrne reviewed several other cases. Each cited different language, but all relied on the *Kieckhefer* decision. *Gilmore v. Commissioner*[56] involved a demand provision.[57] The Tax Court thought that such a provision might create a present interest in the donee if it were unrestricted,[58] but thought that other provisions in the trust agreement were operative to restrict the application of the demand provision. The Sixth Circuit reversed the Tax Court, holding that the demand provision was unrestricted.[59] The court cited the general "right to enjoy"[60] language of *Kieckhefer* in finding that the gift was a present interest.[61]

In *United States v. Baker*[62] the Fourth Circuit, placing reliance on *Kieckhefer*, held that a gift in trust to a minor where the trust agreement directed the trustee to act as if he were the legal guardian of the minor was a gift of a present interest. The court relied on the "source of the restriction"[63] doctrine suggested by *Kieckhefer*, and

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53 Arthur C. Stifel, Jr., 17 T.C. 647 (1951).

54 Crummey v. Commissioner, 397 F.2d 82, 88 (9th Cir. 1968).

55 Fondren v. Commsisioner, 324 U.S. 18, 28 (1945). The court adds, "If motive has a bearing, it is only by reason of its effect upon the element of time and whatever relation may be given, by the particular terms of the gift, to it and the disclosing of a purpose to provide for or against immediate enjoyment." *Id.* Other authorities have criticized a subjective test. *See, e.g.*, Rogers, *Stifel Stifles Kieckhefer*, 7 TAX. L. REV. 500, 501-02 (1952).

56 213 F.2d 520 (6th Cir. 1954).

57 The demand could only be made by the named beneficiary. No provision was made for exercise by a legal guardian.

58 The Tax Court intimated that it did not think that the lack of a guardian required a finding that the gift was one of a future interest. This retreat from the *Stifel* position, however, was only temporary. See note 67 *infra.*

59 Gilmore v. Commissioner, 213 F.2d 520 (6th Cir. 1954).

60 "It is the *right* given to the donee, in the trust instrument, to use, possess, or enjoy, and not the capacity of the donee, which determines whether the gift is one of a present or future interest." *Id.* at 522.

61 The court also alluded to the broader rule suggested by *Kieckhefer*. "The fact that there may not be income . . . is not a contingency imposed by the donor." *Id.* This appears to be another application of the source of the restriction doctrine. See note 39 *supra.*

62 236 F.2d 317 (4th Cir. 1956).

63 "The trust agreement . . . created no barriers to the present enjoy-

also analogized the case to a situation where a legal guardian had been appointed and the gift had been made directly to him.[64]

Another case examined by the appellate court in *Crummey* was *George W. Perkins*.[65] In this case the Tax Court held that a demand provision which was worded to give the beneficiary's parent the power to demand created a present interest.[66] The addition of the parent as one having the right to make the demand was crucial. Had the parent not possessed that power the court would have held the gift to be of a future interest in accordance with one aspect of *Stifel*.[67]

Analysis by the Ninth Circuit

In reviewing these cases, the Ninth Circuit determined that the basis of *Baker, Gilmore*, and *Perkins* was the objective test sought

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ment by the infants of the trust fund beyond those which are established by the laws of North Carolina." *Id.* at 320.

[64] "These gifts to a trustee, since they conferred on the beneficiaries the same right to present enjoyment which they would have had if the gifts [were] made to a guardian for them, must be judged by the same standard as that applied to gifts made to a guardian." *Id.* It has been settled that a gift made to a guardian for the benefit of the minor is a present interest and the donor is entitled to the annual exclusion. See note 19 *supra*. The Commissioner acquiesced in the *Baker* decision. Rev. Rul. 59-78, 1959-1 CUM. BULL. 690.

[65] 27 T.C. 601 (1956).

[66] It is important to note that the parent was not the settlor of the trust in this case. In deciding *Crummey*, the Tax Court said that this was crucial to the holding, and the result would have been contra had the parent been the donor. D. Clifford Crummey, 25 CCH Tax Ct. Mem. 772, 776 (1966).

[67] "Had the power to demand . . . been limited to the beneficiaries or their duly appointed guardians . . . there would have been . . . no person who could make an effective demand . . . ." George W. Perkins, 27 T.C. 601, 605 (1956). Note that the Tax Court rejects the intimation in *Gilmore* and retreats to its previous provision. However, here the court interpreted *Stifel* as requiring only the appointment of a guardian. The court retreats from other aspects of the subjective test. The court did not concern itself with the probability of a demand being made. "Petitioners . . . did not anticipate . . . exercise . . . of that power [the demand power]. But we do not agree . . . that such expectation is more than precatory, or that it vitiates the clear right unmistakably given. . . . Respondent has cited no authority, and we know of none, that a demand by the parents could properly have been resisted." *Id.* at 605. The court continued, "the existence or nonexistence of [the right to demand] at the relevant time must determine the nature of the gifts, not the subsequent conduct of the parents in choosing whether or not to exercise it." *Id.* at 606.

Thus in *Perkins*, the Tax Court adopts the right to enjoy test, and rejects the surrounding circumstances test of *Stifel*. However, the *Stifel* view requiring someone to exercise the demand at the time when the gift is made is reaffirmed.

by the *Kieckhefer* court.[68] The test there sought was whether the beneficiary was legally and technically capable of immediately enjoying the property. This is basically the test applied in *Crummey* although the court focused its attention upon the laws of the jurisdiction as to minors as well as the trust instrument.

On the surface it would appear that the Ninth Circuit merely adopted the general theory first advanced by the Seventh Circuit in *Kieckhefer*. However, careful scrutiny reveals that the decision is much more significant than that. It is submitted that this is the first court to identify clearly the available alternatives and to make a consciously reasoned selection. But most important, it is the first court to challenge the implicit assumption made by the other courts that the disabilities of minority preclude a minor beneficiary from acquiring present legal rights. The court concluded that a minor could make an effective demand even without the appointment of a legal guardian.[69]

This conclusion was reached after an examination of California law.[70] It was based upon the minor's right to own property in California. That a minor could not sue in his own name, or appoint an agent, went only to the issue of whether a demand could be enforced. However, the effect of the demand was not vitiated. For the trustee to ignore the demand would be for him to commit a breach of trust.[71] The trustee would not be required to deliver up the property to the minor, but it would be the obligation of the trustee and not that of the minor to secure the appointment of a guardian who would receive the property.[72]

In devising its test, the Ninth Circuit has evidently overlooked

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[68] "This theory appears to be the basis of decision in *George W. Perkins* . . . . This approach also seems to be the basis of the 'right to enjoy' language both in *Kieckhefer* and *Gilmore*." Crummey v. Commissioner, 397 F.2d 82, 86 (9th Cir. 1968). See text accompanying note 34 *supra*.

[69] "[W]e do not feel that a lawsuit or the appointment of an agent is a necessary prelude to the making of a demand upon the trustee." Crummey v. Commissioner, 397 F.2d 82, 87 (9th Cir. 1968).

[70] In California a minor can own property. Estate of Yano, 188 Cal. 645, 206 P. 995 (1922). He is capable of demanding his funds from a bank, CAL. FIN. CODE §§ 850, 853, or a savings and loan association, CAL. FIN. CODE §§ 7600, 7606. A minor may not sue in his own name. CAL. CIV. CODE § 42.

[71] "The only time when the disability to sue would come into play, would be if the trustee disregarded the demand and committed a breach of trust. That would not, however, vitiate the demand." 397 F.2d 82, 87 (9th Cir. 1968).

[72] "As we visualize the hypothetical situation, the child would inform the trustee that he demanded his share of the additions up to $4,000. The trustee would petition the court for the appointment of a legal guardian and then turn the funds over to the guardian." *Id.*

the decision of the Supreme Court in *United States v. Pelzer*.[73] In that case it was held that the determination of whether a gift is one of a present interest or a future interest could not be subject to the vagaries of local law.[74] This holding would appear to contradict directly the test adopted in the *Crummey* case. However, it is asserted that it does not.

Since the basis of the conclusion in *Crummey* is the right of a minor to own property under state law, then, in any state where a minor can own property, the minor must be deemed to have the power to make an effective legal demand. A minor has the right to own property in every state;[75] and, therefore, an unrestricted demand provision should yield a present interest in any state provided an objective test is used to determine the nature of the interest conveyed. However, this analysis requires further examination.

The Subjective Test

Even if an adequate objective test can be developed, is such a test preferable to a subjective one? The use of a subjective test has mustered strong support. In *Stifel* Judge Franks pointed out that where an examination is limited to objective considerations, it may be possible to create rights which are wholly illusory. In his view, extrinsic evidence may reveal the true nature of the interest conveyed.[76]

Consideration of all surrounding circumstances is required by the test adopted in *Stifel* by the Second Circuit.[77] The court was concerned with postponed enjoyment in the nonlegal sense of factually

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[73] 312 U.S. 399 (1941).

[74] "Respondent . . . insists that the gifts to the named grandchildren are present, not future, interests as defined by Alabama law. He argues that, as [INT. REV. CODE OF 1954, § 2503(b)] does not define the 'future interests' gifts which are excluded from its benefits, they must be taken to be future interests as defined by local law, and it is the local law definition of future interests which must be adopted in applying the section. But as we have often had occasion to point out, the revenue laws are to be construed in the light of their general purpose to establish a nationwide scheme of taxation uniform in its application. Hence their provisions are not to be taken as subject to state control or limitation unless the language or necessary implication of the section involved makes its application dependent on state law.

"We find no such implication in the exclusion of gifts of 'future interests' from the benefits given by [§ 2503(b) *supra*] . . . . It is plainly not concerned with the varying local definitions . . . ." United States v. Pelzer, 312 U.S. 399, 402 (1941).

[75] "The bare fact of infancy constitutes no barrier to the acquisition and ownership of land." 1 R. POWELL, THE LAW OF REAL PROPERTY ¶ 125 (1949).

[76] Stifel v. Commissioner, 197 F.2d 107, 110 (2d Cir. 1952).

[77] *Id.*

postponed economic benefit. It is apparent that the court arrived at a literal interpretation of the statutes. The Supreme Court has often observed that in the application of the revenue laws, the substance and not the form of a transaction should control.[78] The application of this view is manifest in the decision of the Second Circuit.

The problem with applying a subjective test is that, as was pointed out by Judge Byrne in *Crummey*, it may be applied arbitrarily.[79] No guidelines are provided by this approach, and the taxpayer is left to the undefined judgment of either a court or the IRS. Where the IRS is to be the initial arbiter, the courts are often cautious. They are reluctant to allow the Service free rein to make subjective determinations. Guidelines must be provided that will enable effective judicial review of administrative determinations. The substitution of the judgment of a court for the judgment of an administrative official is not satisfactory unless such guidelines exist; otherwise, litigation is encouraged.[80]

In addition to the criticism of inviting repetitious litigation, the use of a subjective test is open to another criticism. It has yet to be contended that actual physical possession and use of a gift is required in order to find that the donee has acquired a present interest. All that is required is the right to such actual use and possession. However, actual use and possession is seemingly the basis for the subjective test propounded by the Tax Court and the Second Circuit. These courts, in attempting to determine the likelihood that a demand would be made, were, in effect, determining the probability that the donee would acquire *actual* use and possession.

Furthermore, the elements of the subjective test as applied by these courts are subject to question. A consideration of the physical capabilities of the beneficiary can lead to no useful conclusion. It may be necessary and even desirable to distinguish between adults and minors with regard to the gift tax, but to discriminate further among minors on the basis of their natural capacities seems unjust.[81] If such distinctions are to be maintained, even the Second Circuit's

[78] Gregory v. Helvering, 293 U.S. 465 (1935).

[79] 397 F.2d at 88.

[80] "Every fact-situation will differ from every other; there will be continued hair-splitting over insignificant differences in the phraseology of the instruments; and if the phrase is ambiguous, hairs may be re-split over nuances of extrinsic testimony." Rogers, *Stifel Stifles Kieckhefer*, 7 TAX. L. REV. 500, 503 (1952).

[81] After all, there is in fact discrimination between adults and minors. Competent adults are not required to have others appointed to manage their property and affairs. There is legislative and judicial recognition of the differences between adults and minors. However, it does not follow that such distinctions were intended in the application of the revenue laws, absent specific congressional instructions to that effect.

judicial knack for drawing fine lines will be somewhat strained.[82] For instance, how does one explain that a demand provision in a trust created for the benefit of a precocious child conveys a present interest while the identical trust conveys a future interest to the average child?[83]

Another factor considered by those courts that have applied a broad subjective test is the foreseeable fiscal requirements of the beneficiary.[84] In the absence of congressional mandate, the courts should not discriminate on the basis of the financial circumstances of the parties in interest. Yet the Tax Court and the Second Circuit considered the financial circumstances of the parents in reaching the conclusion that a demand was improbable.

It also seems incongruous to hold the gift to be of a future interest because no guardian had been appointed. Assuming, *arguendo*, that the minor is incapable of making an effective demand, the fact that a guardian is not in existence at the time of the gift is not significant. Even if a guardian had been appointed, the use, possession or enjoyment of the property would fall to the minor only in such amounts and at such times as the guardian might deem proper. Such restrictions on the right of enjoyment have been ignored by the courts in other circumstances, and there do not seem to be strong reasons for raising such considerations in this context.[85]

There is an additional hiatus in a probability of demand test. Judge Byrne in *Crummey* noted that it was probable that the beneficiaries did not even know of the existence of the trust, much less have knowledge of their power to demand sums from it.[86] In these circumstances the probability that a demand will be made is almost zero. Should this lack of knowledge be construed as requiring a holding that the gift is of a future interest? Clearly this would be inconsistent. A minor is equally unlikely to have knowledge of a gift being given directly to his legal guardian, and such a gift is deemed to be of a present interest. A different conclusion does not seem

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[82] Stifel v. Commissioner, 197 F.2d 107, 110 (2d Cir. 1952).

[83] Randolph Paul doubts that Congress established such excessively fine distinctions which are carefully graded according to the age of the beneficiary. R. PAUL, FEDERAL ESTATE AND GIFT TAXATION (Supp. 1946).

[84] *E.g.*, John W. Kieckhefer, 15 T.C. 111, 114 (1950).

[85] It is not disputed that the relationship of parent and child is one which permits the parent to have considerable influence over his child. The parent may properly exercise his authority to prevent a child from making actual use of a gift. Yet no one contends that this exercise of authority converts a present interest into a future one.

[86] "As a practical matter, it is likely that some, if not all, of the beneficiaries did not even know that they had any right to demand funds from the trust." 397 F.2d at 88.

called for because the gift is given to a trustee. There is no basis for distinguishing between these two fiduciaries in this context.

It is submitted that the subjective test has little to recommend it. A strict construction of the statute and regulations will lead to a finding that any postponed enjoyment in reality leads to a denial of the annual exclusion and the treasury might be slightly more solvent.[87] It is not likely that Congress intended this result when the code provision was adopted. Congress does not appear to desire to discourage gifts being given to minors.[88] It is recognized that the natural and legal disabilities of minority provide sufficient reason for the refusal to give substantial donations directly to a minor. In order to assure that the property will be properly managed and conserved, it is now established that gifts to custodians, guardians, and trustees are appropriate methods for making such donations. Those who make use of the trust should not be penalized by the application of an increased tax unless it is clear that Congress intends this result.

The Objective Test

The establishment of an objective test for the determination of the status of a gift provision as a present or future interest must offer guidance to the taxpayer, yet must not encourage efforts to circumvent taxation by the creation of illusory interests. Such a test has been sought by many courts.[89] The Supreme Court stated in *Fondren* that in the search for an ownership equivalent the *right* to enjoy should be the criterion for such a determination.[90] An objective test may be developed which conforms to this proposition.

It is submitted that the gift should be deemed to be of a future interest if, and only if, there are donor-imposed legal restrictions upon the right to present enjoyment.

When there are legal restrictions on a gift it may be of a future

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[87] Even this has been effectively challenged. It has been noted that the costs of litigation probably exceed the revenues received from the taxation of gifts which are deemed to be of future interests. Rogers, *Stifel Stifles Kieckhefer*, 7 TAX. L. REV. 500, 503 (1952).

[88] This is to be inferred from the passage of section 2503(c) of the Internal Revenue Code of 1954. This section permits the exclusion to a donor upon compliance with the requirements of that section. No determination of whether the interest is future or present is required. The service has refused to apply the maxim of statutory construction, *expressio unius est exclusio alterius*—the expression of one thing is the exclusion of another. Therefore, the exclusion is still available without compliance with these statutory requirements if the future interest hurdle can be overcome. Treas. Reg. § 25.2503-4(c) (1958).

[89] *E.g.*, Kieckhefer v. Commissioner, 189 F.2d 118 (7th Cir. 1951).

[90] Fondren v. Commissioner, 324 U.S. 18, 20 (1945).

interest. It seems appropriate, therefore, that the courts' attention should be directed initially to the trust document. Any restrictions emanating from that source must of necessity be donor-imposed and the gift should be deemed to be one of a future interest. It is possible that legal restrictions may exist which are not contained in the trust instrument.[91] If these are found, then the source of these restrictions must be ascertained. Nondonor-imposed restrictions should be disregarded and the gift found to be of a present interest. If the restrictions are established by the donor, a contrary finding is required.

The Ninth Circuit in *Crummey* has properly concluded that a demand provision may suffice to convey present legal rights of enjoyment to the donee. This is true of a demand provision that is unrestricted in form and application. However, as inferred by the Tax Court in *Gilmore*, it is possible to include a demand provision in a trust and then restrict its application so that it may not be effectively exercised.[92] If such restrictions operate on the demand provision the gift should be deemed to be of a future interest. An application of this proposed test to the facts of the *Crummey* case would yield a result contrary to the holding of the Ninth Circuit.

An unrestricted power to demand all or part of the trust estate will require a finding that the gift conveyed was of a present interest. However, in the instant case the power to demand was not unrestricted. The power was to expire by its own terms on December 31 of any year in which a gift to the trust was made.[93] Upon the expiration of the power to demand, the property was irretrievably beyond the dominion of the beneficiary. He no longer had a right to enjoy the property. It is submitted that the interest created was clearly illusory.[94] The "present right of enjoyment" given to the beneficiary was not of sufficient duration to be considered unrestricted. The restriction was donor-imposed and contained in the trust agreement. It is suggested that this situation is one to which the Second Circuit referred when it expressed its concern about the possibility of creating sham interests which would pass the present interest hurdle in form but not in fact.[95]

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[91] This writer cannot conceive of how a restriction on a present right of use, possession or enjoyment could be imposed outside of the trust instrument. However, this does not presuppose that such a possibility is nonexistent.

[92] Genevieve v. Gilmore, 20 T.C. 579, 583 (1953).

[93] See note 4 *supra*.

[94] Had the gifts been given at one minute before midnight on December 31, the power to demand would have had a total life of only one minute. In the instant case the actual duration of the power was some two weeks, but a different conclusion does not seem called for.

[95] Stifel v. Commissioner, 197 F.2d 107, 110 (2d Cir. 1952).

The Ninth Circuit appears to have been aware of the limited duration of the demand power. However, it considered the limitation as going only to the issue of the probability that a demand would be made.[96] It is submitted, however, that there is a clear conceptual distinction between an existent power which may or may not be exercised at the will of the donee, and a power which terminates and can never thereafter be exercised. The proposed objective test would require judicial notice of these and similar donor-imposed restrictions.

A final caveat is in order. While an objective test is obviously to be preferred, no court may close its eyes to subjective considerations. The taxpayer is ingenious. It is possible that extrinsic factors may exist in some situations which will enable the donor to create the appearance of a gift of a present interest which will in fact be 100 percent future. The courts should not blind themselves to these possibilities in the name of applying an objective test. Experience has shown that a mechanical test cannot be relied upon to produce a proper result in all situations.[97]

In applying *Crummey* or the proposed test derived from the Ninth Circuit's reasoning, no court should be unaware of these possibilities.

Realities

Whether the decision in *Crummey* was correct or incorrect in the circumstances is obviously subject to some dispute. However, it cannot be disputed that in *Crummey* the Ninth Circuit joins the Seventh, Sixth, and Fourth Circuits in adopting a liberal interpretation of the future interest rule. While it is not recommended that *Crummey* be relied upon to produce the same result in other circuits when a demand provision which is so limited is inserted in a trust instrument, it seems safe to conclude that an unrestricted demand provision will yield a finding of a present interest in any of these circuits, and the donor will be permitted an annual exclusion for the gift.

Thus the demand provision can be a useful tool to the taxplanner. In these four circuits it is now possible to establish accumulation trusts for minors and still obtain an annual exclusion for the donor.

M. P. W.

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[96] 397 F.2d at 88.

[97] The fate of the stop, look and listen test proposed by Justice Holmes in Baltimore & O.R.R. v. Goodman, 275 U.S. 66 (1927), is instructive. *See* Pokora v. Wabash Ry., 292 U.S. 98 (1934).